RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Feb. 24, 1988 **LETTER 985**

Feb. 12 DJIA 1983.26; PTI 2652; A-D Ratio -9.50
Feb. 19 DJIA 2014.60; PTI 2646; A-D Ratio -9.19
Current Dow Yield: 3.42%; Dow P/E: 14.6
Dow 200-day mov aver: 2235; DowPow: 987

VALUES: "To know values," stated Charles H. Dow, "is to know the meaning of the market." The time-honored measure of stock values has always been the D-J Industrial Average. In view of that, let's take a look at Dow valuation at this time.

The yield on the Dow is now 3.42%. Historically this places the Dow on the edge of overvaluation. Another way of putting it is that the Dow is currently selling at 28 times its dividends. This is on the high side -- anything over 30 is considered "expensive."

The Dow is selling at 14.6 times its current earnings. In former years (before inflation) a fair price was 10 times earnings, but more recently the norm has risen to around 13 to 14.

Finally, the Dow is currently selling at twice its book value -- I estimate book to be roughly 1020. Normally, a very fair (attractive) price for the Dow is about equal to book value. On this basis, the Dow is vastly overpriced.

Conclusion: The 1988 market advance has positioned the Dow very close to the overvaluation zone again. This is not an encouraging sign, and it underscores my belief that we are still in the early stages of this bear market.

THE PICTURE: The bulls think the bear market is over. They believe it was a three-month bear market lasting from August to October. They believe that the lows were seen last October 19 when the Dow crashed to 1738.76. The bulls believe that the market will break out of its current trading range on the upside and possibly test the 2722.42 Dow high by late this year or early next.

The bears believe that Wall Street continues to be in the grip of a primary bear market. They believe we could be in for a good rally (maybe even correcting half the bear market losses so far), followed by a major decline to new lows. The bears are looking for a recession later this year or next and very possibly a severe recession or even a depression.

What do I think? To me, the overriding consideration is that we are in a primary bear market. Nevertheless, I really don't have any firm scenario in mind as to how this bear market "must" develop. I do know that the bear's "master plan" is to move this market down while taking the greatest number of stockholders with him. How he does that we will have to see as this bear market progresses from its first phase (which we are now in) to the second phase (which is usually the longest phase) and through to the final or liquidation phase.

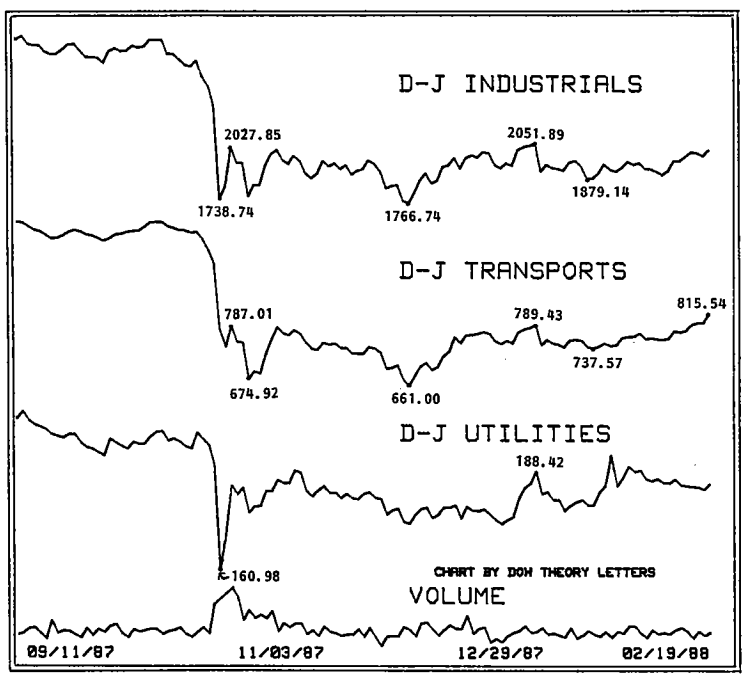
I want to emphasize, however, that regardless of which way this bear market develops, the qualities which every one of my subscribers will need in order to survive the bear are (1) patience, (2) a plan, and (3) knowledge.

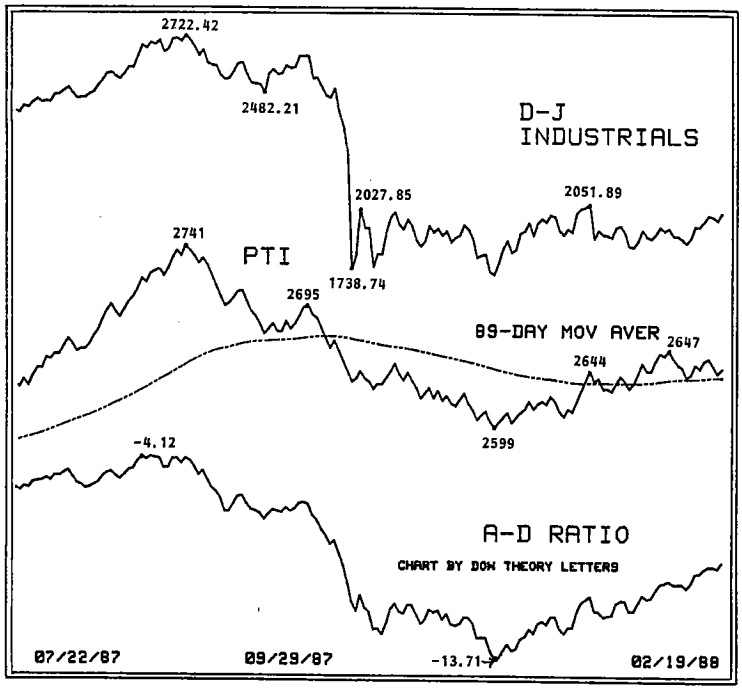
I can tell you right now that it is going to require a great deal of patience and fortitude for you to stay on the sidelines and not be lured back into the market by the bear. I've been saying over and over again that before this bear market is through the bear will use every trick in the book in his effort to get you back into stocks. He'll use convincing rallies, good news, optimistic presidential speeches, new Congressional spending plans, hopeful economic statistics, anything and everything. That's the way bear markets work, and that's why they are so costly to amateur traders and unsophisticated and impatient investors.

As to the plan, your plan should be to remain in a defensive position while letting the bear market run its course. That course may take a year or many years -- depending on how much government interference emerges and how much manipulation is applied to the primary bear trend. From what I have seen so far, I can tell you that I expect the government to fight this bear market tooth and nail. Therefore, my personal guess is that it's going to be a long, drawn-out bear market with many deceptive, even explosive rallies along with the usual tedious sideways movements and, of course, periods of violent decline.

Through it all the investor's very best friend will be knowledge, and in the current situation it will be a knowledge of how bear markets work. A bull market is never a one-way street and neither is a bear market. For example, think back to the early years of the 1974-87 bull market. Do you remember how deceptive, how difficult it was to ride that bull market from its 1974 lows to its 1987 highs? How many investors did ride the bull all the way up? Few, mighty few. Why? Because the bull was trying to advance while taking the fewest number of investors with him. By the same token, the bear will now attempt to decline while taking the greatest number of stockholders with him.

So what I'm saying is that very few traders and investors will have the experience and the discipline to stay out (thereby avoiding losses) of the current bear market. But before this bear market is over America will know that it has gone through its Baptism of Fire.





PRICE ACTION: I've written many times that following a crash (and a crash is a very rare event), the averages almost always retrace around half of the crash losses. I labeled this retracement the "automatic post-crash recovery," and I noted that it is the single surest price action which we encounter in the markets.

More than four months have now passed since the October 19 crash, and we still haven't seen anything like a 50% recovery of the 1987-88 losses (a 50% recovery would take the Dow back to 2230). Such a post-crash recovery, is not guaranteed, of course, but the odds do favor it.

If we don't get that recovery sometime in 1988, the market will appear very weak technically. But I don't want to jump the gun -- we'll just have to wait and see whether the recovery comes. So far the A-D line has acted considerably better than the Dow, and this has been encouraging many analysts.

The better A-D action is now widely recognized, so for all we know this could be just one more trick of the bear. But as I stated in the last Letter, recovery highs in breadth which are not confirmed by the Dow have been the forerunners of many dangerous declines. And as matters stand now, the Dow must better 2051.89 in order to confirm the A-D ratio's hurdling of its own October 21 high.

Overbought: Over any extended period, the market spends as much time going up as going down (in a bear market, the market just goes down faster). In view of this, it is of considerable interest that the advance-decline ratio has been up 10 out of the last eleven weeks. (Friday closings), and the market is therefore quite overbought. Furthermore, considering that the A-D has been up 10 out of the last eleven weeks, the general market has not made any spectacular upside progress.

Thus we should soon see some declines in the A-D, declines that will even up the situation to the downside. I am most interested to see how the market acts on the decline, and this should show up clearly in the profile of DowPow (which has been amazingly sluggish considering the persistent bullish bias of the A-D ratio).

SENTIMENT: Up to this point in the bear market I have not sensed any great fear on the part of the public. Fear will come in its own good time. Remember, the public was wildly enthusiastic about the market right through last August and September. If you remember, people were plowing their hard-earned money into mutual funds, junk bonds, and every kind of new-issue stock right up to the day before the crash. The crash came as a great shock to the public, but now the shock is wearing off, and people are slowly regaining their courage.

Public sentiment (and Wall Street sentiment) does not turn on a dime. Usually it takes six months to a year or even more for a firmly entrenched sentiment to reverse itself. So far, the public has pulled back on their stock buying, but they have not turned bearish. They are certainly not dumping their mutual funds -- they are sitting with their funds while reining in their buying. When this bear market finally gets going in earnest, you will see the public turning hesitant, then nervous, then frightened, and finally panicked. That series of sentiment changes is still a long way off.

I have said that the government will fight the primary bear trend with all the weapons in its arsenal. This will be doubly true during an election year. (Remember, Reagan appointed seven of the Federal Reserve Board governors.) Therefore, expect the government to apply every device and technique in its possession to keep this bear market from expressing itself during 1988. If they can keep the bear market "floating" during 1988 (and it's possible that they can), then I would expect the bear to make them pay for these counter-trend manipulations with a vicious continuation of the bear market (after the elections) during 1989.

I stated that Dow 2230 would represent a 50% recovery of the bear market losses from the peak to the crash low. Use that figure as a guide. If the Dow can't recover to near the 2230 mark during this pre-election year, then label this market weak -- very weak indeed.

Here's another important point to remember. There are not many market analysts writing today who have dealt with the stock market through two or more bull and bear cycles. I'm one of the very few, and I can tell you that I feel it's going to take all of my 40 years of experience and studies (and believe me, I'm still studying) to get us through this bear market with anything like our whole skins. I'm not boasting or playing with your emotions when I make that statement. The fact is that there is just no substitute for experience, study, and knowledge. I only wish I had even more of the three.

WORRIES: The majority of economists and stock market analysts seem to think (1) that 1988 is going to be an "all right" year, (2) that if there is a recession ("which is doubtful") it will be a very mild one, (3) that even if the big Dow stocks are laggard, the secondary and low-priced stocks are fated to be winners in 1988-90.

I think Marty Zweig and I are the only genuine, first-class worriers around today. Oh yes, add *Wall Street Journal* writer, Alfred Malabre Jr. In the February 6 *WSJ* Malabre wrote an article showing that when important stock market declines occur prior to recessions, such action does not necessarily mean that the market will not sink further once the recession begins. On the contrary, Malabre shows that in eight cases since 1948 the market continued to decline AFTER a recession had started.

In the current instance the leading economic indicators have dropped three months in a row. Historically, this has often signaled a coming recession. If we assume that the current three-month decline in the leading indicators is signaling a recession somewhere ahead, then we can also assume that the stock market will (in due time) head significantly lower. Because many of my readers probably missed the Malabre article, I am including his statistics on the stock market and recessions below.

The first column lists the initial market declines prior to each recession. Note the latest entry which is the 23.9% drop in the S&P 500 since August 1987.

The second column shows the date of the beginning of each recession and the duration of each of those recessions.

The third column shows the drop which occurred in the S&P 500 after each recession started. Note that in the case of 1957, 1969, 1973, 1980, and 1981 the drop in the stock market which took place AFTER the recession started was greater than the initial drop

The Stock Market and Recessions

MARKET DROP BEFORE RECESSION STARTS (LENGTH)	START OF RECESSION (LENGTH)	DROP AFTER RECESSION STARTS (LENGTH)
9.1% (6 months)	**November 1948** (11 months)	**8.6%** (7 months)
7.2% (6 months)	**July 1953** (10 months)	**4.2%** (2 months)
6.0% (13 months)	**August 1957** (8 months)	**12.0%** (4 months)
6.7% (9 months)	**April 1960** (10 months)	**3.6%** (6 months)
14.4% (12 months)	**December 1969** (11 months)	**17.0%** (6 months)
13.8% (10 months)	**November 1973** (16 months)	**34.3%** (13 months)
No decline	**January 1980** (6 months)	**7.1%** (3 months)
4.8% (8 months)	**July 1981** (16 months)	**15.3%** (12 months)
23.9% (since August 1987)	———	———

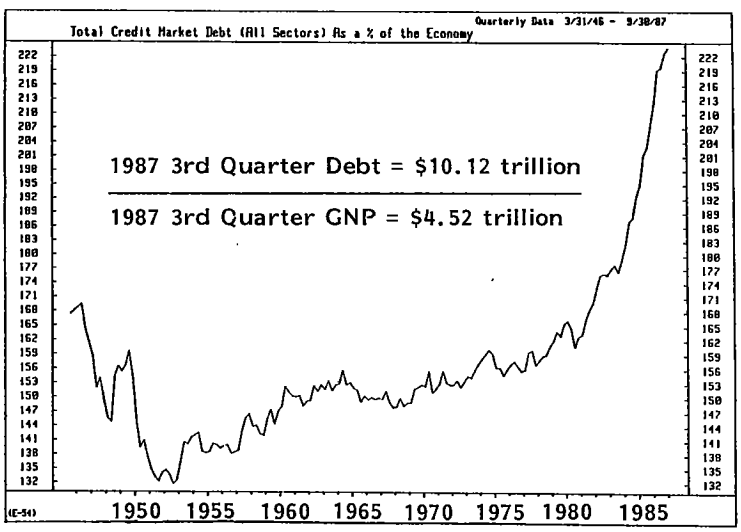
NOTE: Stock market = monthly averages of Standard & Poor's index of 500 common stocks. Recessions as designated by National Bureau of Economic Research.

prior to the recession. If this were to be the case today, we could see a recession start somewhere ahead and then see the S&P 500 decline -- but decline more than the 23.9% which it has declined since last August.

Along these lines, there is one thought that I want to discuss here. It's a concept that I've touched on many times before, and it's this. A recession in an economy with limited debt is one thing. But a recession in a debt-ridden economy (such as the one we are living in) is quite another.

My friend, Marty Zweig, (*Zweig Forecast, Box 5345, NYC 10150)* discussed this same concept in his last report (we've both been worrying about the debt-recession syndrome for quite some time), and Marty included this chart which shows total credit market debt as a percentage of GNP (chart courtesy Ned Davis Research). As you can see, total US debt is now a much higher percentage of GNP than ever before. In fact, the Debt/GNP percentage has been rising almost exponentially.

What will happen when the US finally sinks into recession? In


Total Credit Market Debt (All Sectors) As a % of the Economy
Quarterly Data 3/31/46 - 9/30/87
1987 3rd Quarter Debt = $10.12 trillion
1987 3rd Quarter GNP = $4.52 trillion
1950 1955 1960 1965 1970 1975 1980 1985

view of the current debt level, I think this nation could easily face a debt crisis, a situation where there would be a rush, actually a panic, to gain liquidity. Everyone (individuals, corporations) would want to sell something (i.e., homes, stocks, bonds, collectibles, even gold) in order to raise cash and thus stave off bankruptcy. Such action would, of course, bring the debt-to-GNP ratio down sharply. It would also precipitate (1) an interest rate spike as the acute need for money at any price drove rates higher, (2) another stock market smash, (3) a collapse in the price of almost everything, (4) and probably an out-of-control depression.

Thought: If, for the sake of argument, my worry-scenario comes true, what would be the most intelligent thing for you and me to do? Answer: be liquid -- be loaded with cash. It's axiomatic that if you have what everyone wants, if you own the scarcest commodity around (i.e., cash), you're truly in the driver's seat. Cash in a debt-logged society that has avoided a depression for 47 years -- it's worth thinking about.

Now I want to make another observation. I don't care what the gurus and analysts and smart boys say about the performance of the secondary stocks and the "cats-and-dogs" and even about the bonds, what the Dow does is crucially important. The 30 Dow stocks represent a huge portion of total market value (I believe about 40%). Moreover these 30 industrial stocks are more worked over, more examined, more analyzed, than any group of stocks in the world.

All right, what about the Dow? So far, I feel that the post-crash action of the Dow has been unimpressive. Consider the following:

It's now been four months since the worst crash in stock market history. The Dow at this writing is around 2000, still far from even a halfway recovery of the pointage lost since the bull market high of 2722. If the Dow were to recover just 50% of its bear market losses from the peak to the crash low, the Dow would be at 2230. Yet the Dow is nowhere near 2230.

As a comparison, five months after the 1929 crash the Dow had recovered 52.5% of its peak-to-crash losses. The 1987-88 post-crash performance, so far, has been considerably weaker than the Dow's performance following the 1929 crash. Is this desultory performance telling us something?

Meanwhile, as noted in the last Letter the 200-day moving average of the Dow continues to decline. The 200-day MA is declining at roughly 1.9 points a day and currently stands at 2235. The Dow has been holding BELOW the MA for the past four months. In a primary bear market it is the tendency of the Dow to hold below the MA -- just as the Dow will tend to hold above the MA throughout a bull market (the exceptions to this rule come during counter-trend declines in bull markets and counter-trend rallies in bear markets, but such counter-trend movements are always temporary).

So as this bear market progresses, I will be paying close attention to the Dow and its position in relation to the 200-day moving average. It's a simple but fundamental relationship and one that many analysts ignore.

INVESTMENT POSITION: When I was a kid it cost 2 cents to send a letter, and there were two mail deliveries a day. Now it costs 22 cents to send a letter (with a postage increase coming up), and we're lucky to get one delivery a day. Furthermore, the mail is now slow and erratic, and it can take over a week to get a first-class letter delivered across the country. Is it any wonder, then, our PO is

issuing bear stamps? Here's their new one, the Black Bear. Is this stamp referring to the PO or the stock market? Your guess is as good as mine.

The bear is in the box. The hard decisions and bad news are being held in abeyance by the pre-election hype and shenanigans, and so far our presidential candidates are not even talking about the real problems that lie ahead. For a preview of these problems and some of the underlying reasons for this bear market, you might glance at the Feb. 22 issue of *Newsweek*. Its cover is headlined, "The Pacific Century. Is America in Decline?"

Meanwhile our investment policy is money-market funds, T-bills, T-notes, high-grade muni bonds, dollar-averaging into gold coins, and lots of patience.

MARGIN, CREDIT: In the last Letter I touched on the subject of declining margin debt on the NYSE. In this Letter I want to delve into the debt-credit situation in more detail. It's an extremely important subject, and, in fact, a good friend, Dr. Sloan Wilson,

wrote a whole book about stock market margins and credits back in the the 1960s ("The Speculator and the Stock Market"). I remember that Sloan always referred to stock margins as "the speculator's best friend."

There is an excellent reason for examining margins and credits at this time. The trend of these two can be extremely important in identifying or confirming the primary trend of the market.

First **margin:** This is the total amount of money that customers owe the Exchange (the Exchange calculates this figure once a month). As a rule, margin traders increase their stock positions and add to their margins as a bull market progresses. At or near the bull market top, speculators tend to be up to their ears in margin. Then when the tide turns down, the speculators get battered, and they commence their exit from the market. As they leave (or get killed by lower prices and margin calls) the speculators' use of margin declines. Finally, at the bottom of a bear market, margins on the NYSE may be half or less of what they were at the preceding bull market peak. At the bear market bottom, the margin speculator is thoroughly beaten.

A second item I watch is **credit balances**. This is the total amount of cash that customers have in their cash and margin accounts. As opposed to margins which point to the activities of speculators and traders, the credit balances reflect the action of the unsophisticated, "little" investor (the people who leave a lot of cash in their non-interest-bearing accounts).

Like the odd-lotters, these little investors tend to be wrong all the way up (in a bull market) because they tend to sell as the market works higher. But they are finally correct near the top. At the top of a bull market they are (correctly) flush with cash, and this can be seen in high credit balances at a bull market peak.

By the same token, during a bear market these little guys start buying stocks and they (incorrectly) increase their buying as prices go lower -- thus reducing their credit balances. Finally, near the bear market bottom they are low on cash but flush with stock, so that at the bottom (after taking a beating all the way down) they are finally correctly positioned in that they are fully invested. The proof of this is that credit balances are usually low at bear market bottoms.

Norman Fosback in his fine book, "Stock Market Logic," presents a most valuable study of margins and credit balances. Fosback combined the trend of both credits and margins over the period of 1942 to 1975 and here's what he found: When the trend of both margin debt and credit balances is up, there is a 95% chance that a bull market is in progress and only a 5% chance that a bear market is in progress. When the trend of both margins and credit balances is down, there is a 71% chance that a bear market is in progress and a 29% chance that a bull market is in progress.

Fosback identifies the trend as any time either margins or credits are above or below their 12-month moving average.

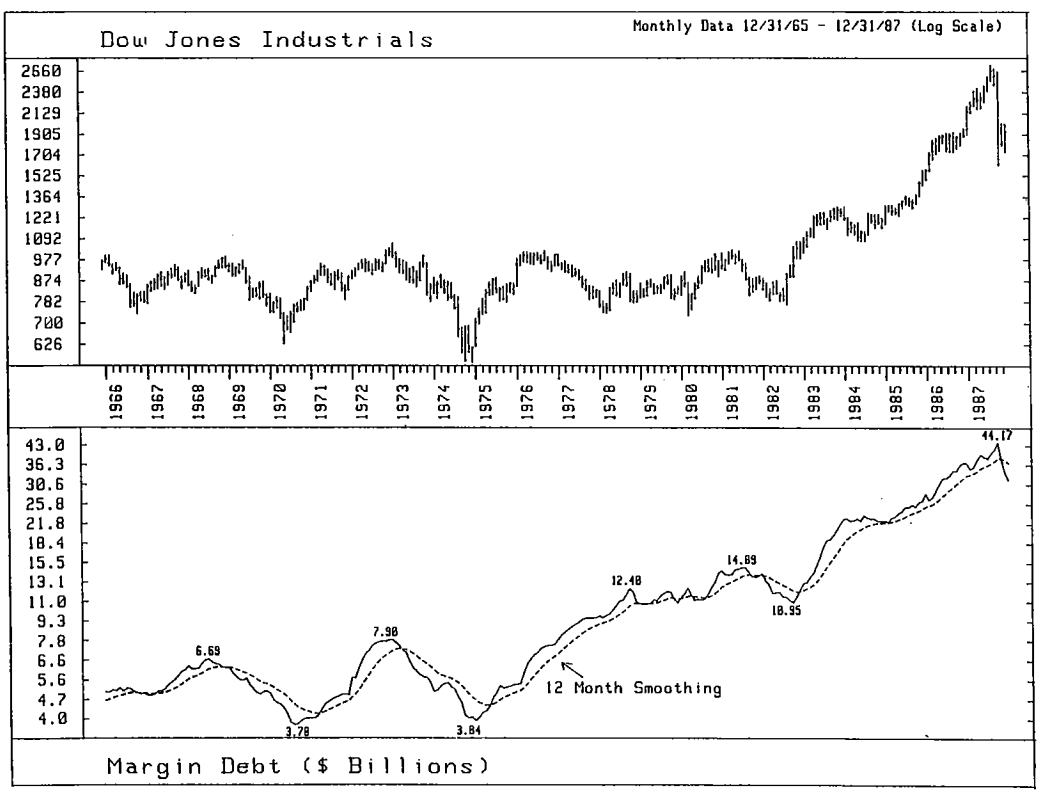
How does that apply to the situation today? From the 1987 high of $44.19 billion, margins have now declined a whopping $12.2 billion or 27%. Margins are now well below their 12-month moving average, and thus it is obvious that the margin speculator has been hit hard -- and is leaving the market.

As for credit balances, the December figures show a major drop of $1.6 billion to $20.39 billion, which takes credit balances decisively below their 12-month moving average.

These studies, based on the Fosback 32-year margin-credit history, indicate that the **odds are now 71% that we are in a bear market.** For your further study, I am including this chart from *Ned Davis Research,* 5600 Glenridge Dr., Atlanta, GA 30342. The chart takes margin debt back to 1966 along with a 12-month moving average.

Note that once margins cross above or below the moving average the ensuing move tends to be an extended one with a minimum of whip-saws. Note also the decisiveness of the recent margin plunge below the 12-month moving average. To me the message is clear. The bear market which began in 1987 has sent margin speculators to the exits.

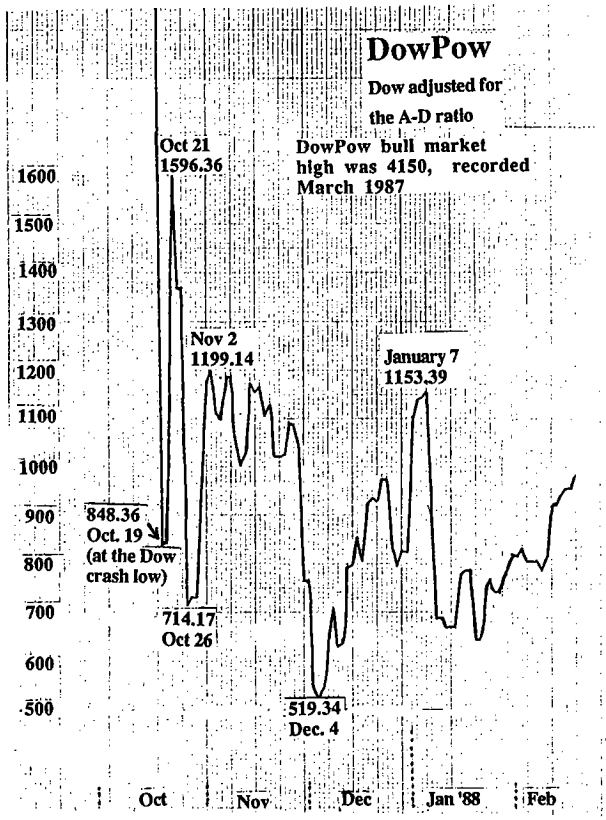
Here's another way of looking at it. The 1973-74 bear market (see chart) saw margin debt drop from 1972's high of $7.90 billion to a bear market low of $3.84 billion, a drop of 51%. If the current bear market was to wipe out 50% of the margin rise from the 1982 low of $10.95 billion to the 1987 high, we would see margins decline to $27.56 billion. But if the current bear market were to wipe out 50% of the margin increase from the 1974 low of $3.84 billion to the 1987 high, we would see margin debt decline to $24.00 billion before this bear market breathes its last.



To me, one critical factor is that between 1974, when the bull market began, and 1987, when the bull market ended, we saw an increase of $40.33 billion in stock market margins. Margin debt has just broken below its 12-month moving average. Margins (along with credit balances) could drop a lot lower over an extended period of time before this bear market breathes its last.

DOWPOW: For the benefit of new subscribers, DowPow is my proprietary index of the Dow adjusted for the action of the advance-decline ratio.

DowPow is still saying that the market's recovery performance since the crash lows has been weak. As you can see on the page 5 chart, DowPow is still fluctuating below its October 21, November 2, and January 7 peaks. As such, DowPow is not confirming the better performance of the A-D ratio and the D-J Transportation Averages, both of which recently bettered their October 21 highs.



What does this mean? I think it's telling us that we're watching bear market action. In a true bull market move, almost all the indicators are in harmony -- on the upside.

NOTES & QUOTES: At the World Economic Forum in Switzerland last week 1,000 people gathered at what was termed "the world's conference of businessmen, government ministers, and economists." The leading subject, according to the NY Times, was "it's the morning after in America and time for the US to stop living beyond its means." With less than no progress on the US budget deficits, our foreign creditors are becoming uncomfortable. In fact, I'd say that the No. 1 topic of discussion among bankers, businessmen, and economists around the world is (1) how long before the US faces the fact that it must bring its deficits down, and (2) will the deficits be brought down voluntarily or by force (the force being foreigners' unwillingness to buy our bonds). So far, the new budget deficits look as though they'll push $175 billion. If we have a recession, they'll be worse.

I don't think most people realize it, but Ronald Reagan has never proposed a balanced budget since he's been president. In 1980 Reagan proposed a budget with a deficit of $29 billion, but the actual deficit came in at $73.8 billion. In '81 the proposed deficit was $15.8 billion but the actual was $78.9 bils. In '82 the proposed was $27.5 bils. and the actual was $127 bils. In '83 the proposed was $91.5 bils. and the actual was $207 bils. In '84 the proposed was $188 bils and the actual was $185 bils. In '85 the proposed was $180 bils. and the actual was $212 bils. In '86 the proposed was $180 and the actual was $220 bils. In '87 the proposed was $142 bils. and the actual was $148 bils. The new '88 budget is another disaster with a planned deficit of $129 bils. which will probably end up at $175 bils. In all, an abysmal, absolutely disastrous performance by a president who had the gall to state in September 1981, "This Administration is committed to a balanced budget, and we will fight to the last blow to achieve it by 1984."

All of this is having its effect on the world political scene and even the newspapers are beginning to pick up the implications of a giant that is weakening and hemorrhaging due to its compounding deficits. An article in the January 7 *LA Times* notes that whereas the US was once the locomotive for the free world, it is fast becoming the caboose.

Role as Leader of World Economy Shifts as U.S. Global Debt Grows

By JONATHAN PETERSON,
Times Staff Writer

The United States was the world's economic locomotive, went the popular wisdom. Its sturdy industrial engine would clatter and grind and tow the aspirations of other countries forward with it.

Foreign countries relied on the well-heeled American public to buy their products—in many cases, even more than they counted on their own consumers. Similarly, many U.S. manufacturers—content with the rich market in their own backyard—did not try very hard to sell abroad. But America paid a price: a growing loss of control over its economic destiny in the form of a foreign debt, which could exceed $500 billion by 1990.

...imbalance, which has threatened

The SEC is conducting a civil investigation of Drexel Burnham Lambert and the US Attorney's office is handling the criminal side. Drexel is conceding nothing and preparing to defend itself. The government has requested 1.6 million pages of documents from Drexel. The entire document search has cost $8 to 10 million, the cost of photocopying alone has been $1 million, and the total cost in legal fees to Drexel so far is estimated to be around $70 million.

* *

LA has become the gang center of the US with gangs of every ethnic variety now fighting for turf. LA gangs are now "franchising" territories in other cities and automatic weapons are have taken over from the home-made "zip guns" of the 1960s. It is estimated that the most poweful of the LA gangs are the black gangs with over 25,000 members. Last year LA suffered 387 gang-related killings.

The reaction to all this crime is fantasy revenge and Hollywood is starting to grind it out via a torrent of new cop pictures. Al Pacino, Bruce Willis, Robert De Niro, James Woods, Mark Harmon, James Caan, Sam Elliot, Clint Eastwood, all will be playing cops in coming flicks. There -- that ought to put some fear into the gangs.

* *

My friend Charlie Allmon runs the *Growth Stock Fund*, and he also publishes *Growth Stock Outlook*, PO Box 15381, Chevy Chase, MD 20815. Allmon's is one of the few funds that escaped almost unscathed from the market crash. Charlie often makes incisive comments in his *Outlook*, and I repeat a few below from his latest mailing.

REVOLUTION IN PROGRESS — Our friends at C. J. Lawrence sent along some most interesting data on the revolution under way in photovoltaic energy. To date, solar energy has failed to compete in the energy arena because of the high cost per watt. In 1983, cost per watt was $8. In 1991, cost per watt for photovoltaic energy is estimated at $2, a 75% reduction. Perhaps by century end cost will be down to $1 per watt. Should that happen, oil might once again sell at $3 per barrel, and Texas oil tycoons may have to go to work . . . and desert sheiks may once again be riding camels rather than in Cadillacs!

GOODBYE INDEXING! — For a couple of years, indexing was all the rage. This indexing mania grew out of money managers' inability to beat the S&P 500. So tens of billions of dollars moved into indexing, an admission of mediocrity. Then along comes 1987. Alas, pension funds utilizing indexing would have been much better off in a five percent savings account. Who knows? Perhaps 1988 will produce more of the same. Those using the index route tacitly admit they simply want to be average. And they will be!!

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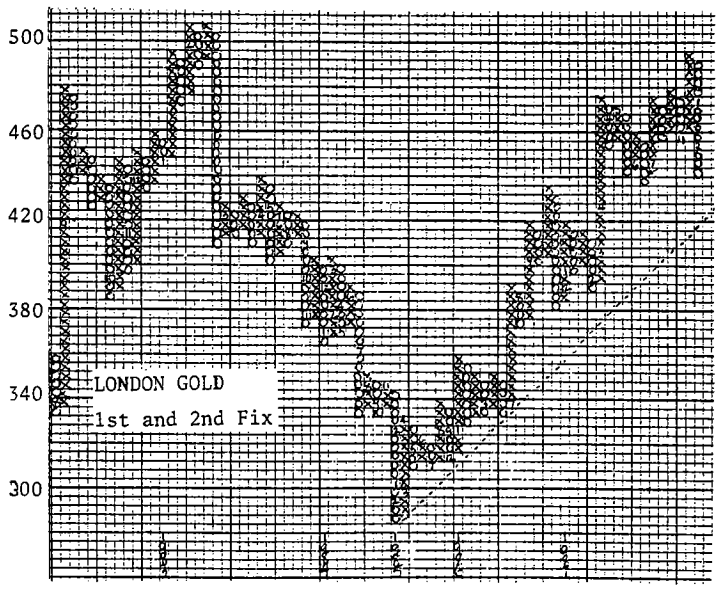
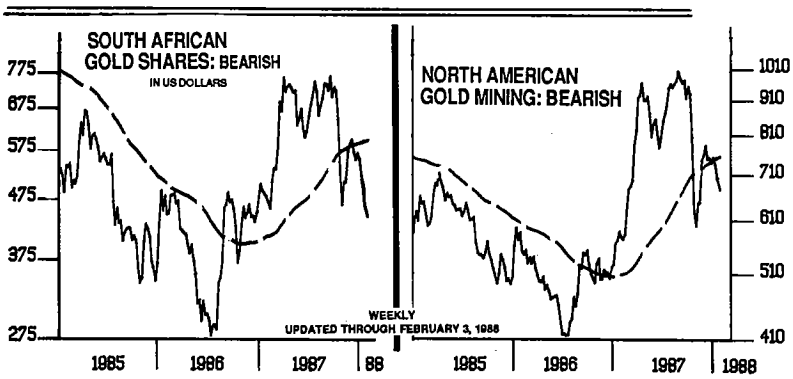
Question: Why aren't American corporations screaming bloody murder about foreign imports? Answer: Because they're cashing in on them. Roughly 30% of the US trade imbalance with the Pacific Rim nations is due to US corporations making items there and shipping them here or else just bringing the items here and slapping their labels on those items. For instance, do you know who the largest exporter of computers from Japan is? Surprise -- it's IBM. IBM Japan has 18,000 employees and annual sales of $6 billion. Of the four largest exporters from Taiwan, one is RCA and one is AT&T. Ah yes, if you can't beat 'em ... .

* *

How do you beat inflation? Easy, change the base from which the inflation figures are calculated. Since 1971 the Labor Dept. has used 1967 as the base for the Consumer Price Index and the Produce Price Index. For example, a basket of consumer goods and services which cost $10 in 1967 cost $34.57 last December. But beginning this month the new base for comparisons will be 1982-84 for the CPI and 1982 for the PPI. So that's how our government beats inflation -- as the old adage goes, ""Figures don't lie, but liars can figure."





GOLD: Everybody's bearish on gold. But my gold charts have not yet broken down. I'm talking about gold bullion. I include here my point & figure chart of gold, and as you can see, gold would have to sink to 436 to break below its last low. And gold would have to sink to the 416 level to break below the rising trendline, a trendline that stretches up from the 1985 low.

The gold shares are another story. I am including these two charts from the *Aden Analysis,* 2400 Jefferson Highway, Jefferson, LA 70121. Here we see both the S. African and N. American gold mining indices breaking below their long-term or 65-week moving averages. As I see it, there was entirely too much speculation going on in the gold shares, speculation that ignored the political liabilities of S. Africa and speculation that ignored the overvaluation of the N. American gold shares. During 1987 I had the feeling that many people wanted to own gold shares at any price. They got 'em all right, but the "any price" was far too high.

What next? I can't give you reasons, but I just don't feel gold bullion is going down the drain -- pricewise. I think gold may sit here, drift around a bit, but I'm just not bearish on gold itself. Maybe my thought process is just emotional. Maybe it's because I'm still buying the bullion coins on a dollar averaging basis (a fixed amount each month) and honestly, I don't give a darn whether gold goes up or down. I'd as soon pay $300 for American Eagles or Maple Leafs as I would $600, and, in fact, since I want to continue accumulating gold I guess I'd rather pay $300.

You've got to remember that buying gold is totally different than buying gold shares. When you buy gold you're buying an item of value that will be here forever. Gold (unlike stocks) doesn't go out of style, it doesn't need any government's approval, it has no debt against it, and it has a 5,000 year history of being money. The value of all paper money fluctuates daily against gold, but every single paper money in history has (in due time) gone down the drain. And the gold that was money in the time of the Pharaohs is still money today.

Back to the present. Bullion halted its descent close to the 440 level, and it seems to want to sit around 440 for a while. So the truth is that I'd rather buy gold here than short it. That's the way I feel. If I'm wrong, we should know it fairly soon. But as I said, everybody's now bearish on gold and "everybody" is seldom right.

LATE NOTES: I've been writing about "the 50% post-crash correction" ever since late-October, and I'm beginning to wonder if it's fated to be. As this is written, the Dow is again within shooting distance of its January 7 peak. But a major non-confirmation now exists in that the Transportation Average has bettered its January 7 high while the weaker Industrial Average has refused to confirm (a confirmation would entail the Dow bettering its January 7 peak of 2051.89). A persistent refusal by the Dow to confirm could lead to trouble (resumption of a primary bear market has often started with a major non-confirmation in the Averages).

What if the Dow does confirm? Last time the Averages both bettered preceding peaks we witnessed a total "fake-out" as the Dow dropped 140 points on the next trading day. If Dow 2051.89 is bettered this time I would hope that it's not another fake-out, but this is a bear market and those who insist on trying to beat the bear "pays their money and takes their chances."

Barron's Trader column noted that so far this year the Dow is up and volume is down. That trick hasn't been performed over a full year since 1956. The Trader noted that volume for a full year has declined only six times in the last 31 years, and each time the Dow was down for the year, the average decline being 16.1% (the last full-year volume decline occurred in 1977 with the Dow down 17.3% that year).

As a rule, bull markets generate rising volume and bear markets bring on declining volume. So I view 1988's declining volume as just another confirmation of the primary bear trend. I also view the declining volume as ominous (it parallels the decline in margins, see pages 3 and 4).

As mentioned earlier, the last thing this Administration wants is people struggling through long unemployment lines to get to the voting booths. In view of this, the Fed may now be trying to pave the way for a spurt in business. Free reserves in the banking system are now bulging to around $1 billion and thus the banking system's cup runneth over.

The latest (January) figures for Margin Debt and Free Credit Balances on the NYSE show fresh declines to new lows for the year (see page 3-4).

NEXT MAILING: March 9